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FM AMCONSUL HONG KONG
TO RUEHC/SECSTATE WASHDC PRIORITY 4815
INFO RUEHOO/CHINA POSTS COLLECTIVE
RUEHHI/AMEMBASSY HANOI 3741
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RUCPDOG/USDOC WASHDC
RUEHIN/AIT TAIPEI 4928
RUEAWJA/DEPT OF JUSTICE WASHINGTON DC
RULSDMK/DEPT OF TRANSPORTATION WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUEAUSA/DEPT OF HHS WASHINGTON DC
RHMFIUU/DEPT OF HOMELAND SECURITY WASHINGTON DC
RHEHNSC/NSC WASHDC
RUEAEPA/HQ EPA WASHDC

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SENSITIVE
SIPDIS

STATE FOR EAP/CM, EAP/PD
STATE PASS TO USTR CHINA OFFICE/TIM WINELAND
STATE PASS TO CPSC RICH OBRIEN/INTL PROGRAMS
STATE PASS TO DOT FOR NHTSA ABRAHAM/KRATZKE
STATE PASS TO OMB/INTL AFFAIRS
STATE PASS TO HOMELAND SECURITY COUNCIL
STATE PASS IMPORT SAFETY WORKING GROUP
HHS FOR OGHA//STEIGER AND FDA/LUMPKIN
USDOC FOR 4420 MAC/OCEA/ACINO
USDOC FOR 6300 MAS/HIJIKATA

E.O. 12958: N/A

TAGS: [ECON](#) [ETRD](#) [EIND](#) [BEXP](#) [HK](#) [CH](#)

SUBJECT: TOY SAFETY VIEWED FROM HONG KONG: IMPROVED, BUT
STILL AT RISK

REF: A. HONG KONG 2217
[1](#)B. HONG KONG 2414
[1](#)C. BEIJING 1492
[1](#)D. GUANGZHOU 225

[1](#)1. (SBU) Summary: Chinese-manufactured toys are much safer than they were a year ago, but new price pressures threaten to compell even responsible manufacturers to try to cut corners. Toy manufacturers, business and association leaders, and laboratory testers universally claim that the industry has responded positively to the "wake-up call" of August 2007's series of high-profile recalls and adverse media attention. Toys "Made in China" are safer in May 2008, as brands are demanding increased accountability, manufacturers are testing more product more often, and the PRC government is enforcing export quality control at an unprecedented level. Things are tough in the toy business though -- Mainland China's new labor law, environmental regulation enforcement and appreciation of the RMB are driving less sophisticated manufacturers out of the market entirely, while survivors face unremitting downward price pressure from U.S. brands and retailers. The Hong Kong-owned toy industry is acutely aware of the forthcoming U.S. product safety law, with many companies already investing in necessary infrastructure and operational changes. Manufacturers believe global harmonization of toy standards is the most efficient and effective method for product safety, but understand such harmonization is unlikely given the current diversity of national and voluntary standards. Substantial testing and analysis capacity, through investment in personnel and equipment, is essential to respond to the enactment of the U.S. law, say Hong Kong business leaders. End Summary.

[1](#)2. (SBU) Background: Since the August 2007 toy recalls, Post has been working with the Hong Kong toy manufacturing associations (owners of the majority of toy manufacturing

plants in Southern China) to analyze developments in the toy industry and consumer product safety. Conversations with the senior leaders of the Hong Kong Toy Manufacturers' Association, the Hong Kong Toys Council, Modern Testing Services (MTS) and SGS global testing laboratories, and a representative of the International Council of Toy Industries (ICTI) contributed to this report on the state of the toy safety industry in May 2008.

Toys Are Safer Than in August 2007

13. (SBU) Toy manufacturers, business and association leaders, and laboratory testers universally claim that the industry has responded positively to the "wake-up call" of August 2007's series of high profile recalls and adverse media attention. Lawrence Chan, Chairman of the Hong Kong Toy Manufacturers Association, described the movement's defining moment: the visit by PRC central government leader Madame Wu Yi to Southern China in November 2007. He explained that Madame Wu's visit to nine toy manufacturing plants had a "real impact" on the owners, managers, and employees in conveying the seriousness of the issue. The combined result of industry's response is that in May 2008, brands are demanding increased accountability, manufacturers are testing more product more often, and the PRC government is enforcing export quality control at an unprecedented level. In short, "U.S. toy imports 'Made in China' are safer now than last year", confirmed Ian Anderson, a toy safety consultant with SGS and ICTI.

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14. (SBU) Action from within the supply chain is not the only contributing factor, however. As noted in reftels from Guangzhou and Beijing, key developments in mainland China, including the labor law, environmental regulation enforcement, and appreciation of the renminbi (a predicted 12 percent for this year), are leaving a wake of closed manufacturing companies. Hong Kong toy company owners noted the departure of many Korean business owners "in the dark of night" as the labor law took effect, to avoid back payments of overtime, and the move of numerous Taiwan-owned companies to cheaper environments in Southeast Asia. Rising prices for raw materials, fuel and food are tightening profit margins even further. As in most mainland China industries, company owners provide housing and food in addition to wages, and many companies are still operating their own diesel generators three days per week, as electricity supplies have not recovered since last winter's infrastructure-destroying storms. (Note: Hong Kong toy manufacturers expect to add ten percent to their manufacturing cost as they renegotiate contracts in May, on top of ten to fifteen percent for 2008 due to enhanced safety measures, announced earlier. End Note.) Any company operating on the edge of profitability in 2007, including those cutting quality corners to make toys, is no longer in business, say many observers.

But A Risk Remains

15. (SBU) Less sophisticated manufacturing companies are being driven out of the market, but higher costs, and smaller margins throughout the entire supply chain, and continued intense downward price pressure from buyers may compel some manufacturers to continue to cut corners. In this economic- and safety-focused environment, both buyer and seller are choosing products, timing and terms more carefully, all as pressure for the lowest price remains acute. Edmond Young, Managing Director of Perfekta Industries, explained that some manufacturers are walking away from high-risk contracts, for instance, fabrication of a toy with extensive paint. The more paint, the more testing needed, and the higher the production cost, he said. The majority of toymakers are

original equipment manufacturers (OEM) without their own product lines, so they must rely on these global brands and retailers as customers. Smaller, less established companies are less able to turn away business and more likely to make up the cost in some other area of the production. Planning for a profitable year is further clouded as "buyers are also holding back on orders so far this year -- they are waiting to see what will happen with the downturn in the U.S. economy", said C.K. Yeung, of the Hong Kong Toys Council.

16. (SBU) Risk to toy safety remain: some companies are still "shipping out the back door" without testing, or exploiting loopholes such as shipping cheap toys as "party favors" or "gifts," not subject to the same safety standards as toys, said Yeung. Industry expert Anderson noted that Hong Kong-owned manufacturing companies are among the most price-conscious in the world. Many operate with dual sets of books and pay far less than China's minimum wage to maximize profits. With margins so tight, business owners may take chances in the supply chain that impact product safety, he said.

New U.S. Regulations Can Help, But Need Time

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17. (SBU) Awareness of the forthcoming U.S. product safety law is high across the Hong Kong-owned toy industry, and many here are proactively planning for its enactment. Primary concern focuses on implementation timetables and lead content level and testing methodology. All parties agreed that three to six months is the bare minimum needed to implement the new standards and to avoid a "major recall" tied to the U.S.'s new, more strict standards. Based on the EU's RoHS standard implementation for electronic products, a full three years is needed for complete effectiveness and absorption into all levels of the supply chain, said ICTI's Anderson. Local industry, despite advocacy efforts by the U.S. Toy Industry Association, does not fully agree that risk-based testing of all product content (rather than just the hazard-based accessible parts and surface coating test used by the EU) is the most effective or necessary standard. However, they are investing in infrastructure and altering operations to accommodate the new U.S. rules.

Harmonization as the Ideal

18. (SBU) Consistent with the message heard in mainland China, the United States, and in Europe, toy manufacturers point to the harmonization of standards as the most efficient and effective method to improve product safety. Even laboratory testing companies who stand to lose testing business agree that a global standard, voluntary or not, would aid manufacturers in producing toys for a wider market, more safely and with greater profitability. Business, association, and testing leaders acknowledge that the possibility of reaching such global harmonization is unlikely, however, citing the current diversity of national and voluntary standards. In the United States, for instance, numerous state-level initiatives now supersede federal law on lead levels alone, not to mention other toy standard categories, as detailed on the Intertek testing laboratory's website: www.intertek.com/consumergoods. Anderson went so far to say that the new U.S. law will actually delay harmonization further as it adds new complexities across standards, and once enacted, United States regulatory momentum on the issue will slow.

Testing Capacity is Key

19. (SBU) Greater testing and analysis capacity is needed to respond to the enactment of the U.S. law. Management at MTS testing laboratory estimates that 10,000 people, and millions of USD in investment in equipment and facilities are needed to respond to the expected demand. Many of these personnel must have expertise in chemistry, and the equipment must be capable of analyzing to the new 90 parts per million lead standard. Mr. Yeung explained that prior to August 2007, one batch of 100,000 pieces (toys) would be tested just once before being exported. Today, that batch will be broken into five batches of 20,000, with each group tested four times throughout the supply chain. In some instances, the certification of a single product requires hundreds of individual tests on each paint and part, requiring five days or more for processing. Some areas are already seeing shipping delays as existing laboratory capacity responds to the rising curve of accountability since last year. Hong Kong toy industry leaders see lack of testing capacity as a potential choke-point to the smooth implementation of the new

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U.S. law.
Cunningham